

## TAX NEWS & TIPS

MID-YEAR 2013

### Whew! It's Over!

Tax season was brutal this year. Last-minute law changes and late form releases made things difficult. I fear change is in store.

Before I forget, I owe you a big **THANK YOU!** Thanks for having your records in good order. Thanks for being patient at my busiest time. Especially – Thanks for the trust and confidence you placed in me. I'll keep working to earn this from you.

### Late Tax Help For 2012 & On

Talk about last-minute reprieves! A tax law passed New Year's Day, and signed on January 2. Wow!

Average folks are big winners. Higher-income Americans, however, face several increases in both their regular income tax and their social security tax.

Budget woes are still with us. The new rules don't raise a lot of revenue. Expect more changes, possibly a complete revamp of the tax system over the next few years.

#### EXTENDED PERMANENTLY

✓ **Tax Rates** will remain at 10%, 15%, 25%, 28% and 35% for most Americans. No more waiting for rates to expire every few years. A new 39.6% rate now applies to singles over \$400,000 of taxable income, and couples over \$450,000. That's less than 2% of all filers.

✓ **Benefits of Children** remain for most folks. A child under 17 cuts \$1,000 off your tax. This benefit "phases out" for higher incomes. Also kept in place – favorable rules for child-care expense, and liberal rules for the Earned Income Credit for low-income parents.

✓ **Capital Gains & Dividends.** Low rates on capital gains are made permanent. Ditto the rule taxing "qualified" dividends as if they were capital gains.

New rates for wealthier folks. Capital gains now have "graduated" rates, similar to regular tax rates. Added to the old 0% and 15% rates is a new 20% rate for gains falling in the new 39.6% tax bracket.

✓ **"Marriage Penalty" Items.** Two key aids for couples were made permanent. The standard deduction for non-itemizer couples will remain at double the value for single folks. Same for the "break points" where the three lowest tax brackets begin.

✓ **Education.** The American Opportunity Tax Credit helps college undergrads. This has been extended through 2017. It's a dollar-for-dollar return of the first \$2,000 spent, plus 25% of the next \$2,000. Cost of tuition and fees, books, supplies, and course materials, needed computers and on-line fees all count.

✓ **Other "Fixes".** Alternative Minimum Tax "exemption" amounts are now set for automatic indexing. No more annual last-minute fixes. Plus, the rules allowing common credits even when AMT is present are made permanent.

#### MORE HIGH-INCOME RULES

Other 2013 changes will affect only the 3% - 5% of Americans with highest income.

- **Medicare Earnings.** Singles with wages over \$200,000 will pay an extra 0.9% in Medicare tax. For married filers, it starts at \$250,000, but employers will withhold above \$200,000 and we'll need to claim the excess on your tax return.
- **"Investment" income** faces a 3.8% Medicare tax for the same folks. Complex rules will sort your

income as "investment" or "other". The investment income "floats" at the top of the income pile and is subject to the extra 3.8% tax.

- **Itemized Deductions** will again be reduced for high-income folks. Starting at 250,000 for singles and \$300,000 for couples, you'll lose \$3 of deductions for each \$100 of extra income.
- **Exemptions** for yourself and for your children will be reduced at the same starting income levels.

#### EXTENDED FOR 2013 ONLY

Some extended rules end this year:

- **Charity from an IRA.** Folks over 70½ can deduct contributions if sent by IRA Trustee to charity.
- **Itemizers** may deduct sales tax if larger than state income taxes.
- **Mortgage insurance premiums** are deductible for homeowners.
- **Tuition and fees deduction** for college & grad school.
- **Businesses.** Helpful credits and expensing and depreciation rules.

### This Issue

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## Energy Credits

### Big Savings For "Going Solar" & For Electric Cars

Only a couple of energy credits are still here. No more credits for insulation, energy-saving appliances, and insulating doors and windows.

**Generating Energy.** I'll discuss homeowners' credits. I'll ignore the complex incentives for businesses.

Credits for *generating* energy can be claimed for any property you use for personal living, even a second home or vacation property. No rentals, however – they are covered under business provisions.

Tax law offers credits for energy from solar, wind, geothermal, and fuel cell sources. The only common item here is solar. You cut your tax by 30% of the system's cost. These are expensive, but 30% is a nice savings! Plus, the saving is virtually guaranteed. If the credit exceeds your tax bill, you carry the excess to next year's tax bill. If you don't get all of it this time, carry it again!

A small warning. No credit is allowed for recreational water use. Use solar to heat your bath water and you get a tax credit. But, use solar to heat the water in a pool or spa, and no credit will be allowed!

Shop for more than tax savings. There are incentives galore. Many utility companies offer rebates and

special rates. Ask about them. Sales people know what's available – it helps to sell their products.

After you find the best deal, ask about other savings. I know Federal rules. Many states have tax credits as well. Ask about them. Lots of us shop on-line these days. If you find a great price on an item, don't stop there. Visit a local store, or call a local dealer or installer. Find the same product, and ask about benefits offered in your state. The on-line stores often overlook these benefits.

**Electric Vehicles.** New electric cars are expensive. The credits are large – they start at \$2,500 and often go to \$7,500. Ask the dealer, and take the credits into consideration.

The "golf cart credit" is gone. There used to be a credit for small electric vehicles resembling golf carts. To qualify for the 2013 credit, the vehicle must be capable of a speed of at least 45 miles per hour.

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## Big Income This Year? Call Me!

If you expect a sudden income jump this year, we need to talk. Sold stock or property? Got a big bonus? Had an unexpected windfall?

Notice, I said "income *jump*". If your income is usually high, we both are aware of the numbers, and I've

always tried to keep you up-dated on law changes. If your income will suddenly be very much larger than I normally see, be sure to let me know.

I mentioned special tax rules for high-income folks on the previous page. If you think you might be affected for 2013, let's take a look at your numbers.

The rules are new – very new. IRS has not even developed forms for most of the changes! However, I have a pretty good grasp of how the new rules will work. We should be able to make reasonable estimates of how much they'll cost you.

Remember who we're looking at: single filers and heads of household with income of \$200,000 or more. For couples, think \$250,000. If you file "married filing separately" it's only \$125,000.

If you will owe significant tax, there's even the possibility of a penalty unless you make estimated tax payments.

Frankly, I hope your tax bill next year is huge! It's supposed to be a really nice problem! But, if either of us is surprised at the total bill next February or March, it means one of us didn't do his job!

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## After Your Tax Return Is Filed - - -

**All Done?** Not quite. Some returns were extended, some of you still owe money, a few refund checks may go astray. When our work is *done*, IRS *begins* it's work.

**Loose Ends?** Some of you aren't quite finished:

**Extended Return?** Returns are due October 15. Payment was due April 15. Carrying charges apply after this. Gather your missing paperwork to avoid surprises.

**Refund Late?** IRS won't help until 6-10 weeks after you file. 1-800-829-4477 is for automated help. 1-800-829-1954 is the refund hotline. The IRS website, [www.irs.gov](http://www.irs.gov), has a "Where's My Refund" link.

**Find an Error?** If you failed to claim an item on your return, we can file an amended return. You and IRS each have the same time frame to question your return. It's 3 years after the filing deadline. If you owe IRS you pay the tax plus some interest. If IRS owes you, the same thing applies – you collect the tax savings plus interest.

**Keep Your Return and Records.** For now, put your return, records, receipts, and cancelled checks in a safe place. You should keep the tax *returns* indefinitely. The *records* should be kept for 5 years. You might need to dig them out, but chances are slim.

**Will You Be Audited?** Not likely. This Fall IRS will match reports from banks, brokers, and employers with tax returns. "Audits" arise when IRS finds a mismatch.

**Uh-Oh – an IRS Letter!** If you get a letter from IRS, call me. The letter may be confusing. There are several types of notices and each requires a different response. Don't risk turning a simple inquiry into a royal mess – I'll be glad to handle it.

When IRS questions anything on your return they call this an "audit". Most people think of an "audit" as a face-to-face meeting with an IRS employee who asks lots of questions. IRS just released statistics for the fiscal year ending in September 2011. They received about 141 million returns, and "audited" 1.46 million of these. That's just over 1% of the total. Of these, only 24% called for a meeting with an IRS auditor – the rest were handled by correspondence.

These correspondence "audits" usually arise from the IRS "matching" program. They involve copying your records and verifying the return. Face-to-face audits are more complex. We'd need to meet and discuss all the issues. Please remember, only about 1 in 400 of all returns is subjected to this sort of scrutiny.

## Tax Tips For June Grads

Congratulations! School's done and you're ready to start a career. Here's help for both you and your parents to keep your taxes low.

### ☑ Last Chance For Low Rates.

Unless you earn over \$46,000 this year, you are in the 15% tax bracket or lower. I hope your bracket goes up quickly in the future. For now take full advantage of the low rate

### ☑ Don't Withhold Too Much.

Tax refunds are nice, but why let IRS hold your money? Withholding tables expect a full year of income. If you only work part of the year, too much is withheld. Call me. I can help you adjust your withholding.

### ☑ Itemizing Deductions is

possible, but not likely. You will probably use the standard deduction of \$6,100 for 2013. Itemizing helps if your deductions are higher. You can deduct state tax withheld from pay and gifts to charity. Medical expenses and job-related expenses have "floors" – only excess costs count. Job items include professional dues, books and publications, tools and supplies used in your job.

**Job-Seeking Costs.** No help on finding a first job. But, once you have a work history and can itemize, cost to find work in the same field is deductible. Count costs of resumes, copying, postage, phone calls, and travel for interviews.

**Moving Expense** is deductible – even for a first-time job! Even better, you get the deduction "up front" even if you can't itemize your deductions. In changing jobs your commute to work must increase at least 50 miles compared with your old commute. For a first job, moving is deductible if the job is more than 50 miles from home. Costs to move belongings and the cost of travel to the new site are included. This includes cost of packing, storage, and insurance.

☑ **Education Costs.** Education costs include tuition, fees, books, and supplies, including computers. Tax law offers both adjustments (No need to itemize!) and tax credits! Choose whichever gives the most tax benefit. There's a catch – whoever claims your personal exemption gets these. That might be Mom and Dad for this last year of college.

**Help For Mom & Dad.** Can Mom and Dad claim you as a dependent?

If you are not age 24 at year-end and were a full-time student for any part of 5 months, they probably can. Frankly, the overall tax savings are probably greater if Mom and Dad claim you as their dependent.

If you will be 24 by year-end, your parents may not claim you if your earnings exceed \$3,900.

The distinction is very important. Both the dependency exemption and the right to claim the education credits or deductions are affected.

**Keep Records.** Now that you're officially a taxpayer, you'll be held responsible for recordkeeping.

You'll need to learn to keep both receipts and canceled checks (or other proof of payment) for tax deductible items. You need to show *why* an expense is deductible. Learn to document the circumstances. The habit will pay off if you are ever audited by IRS. You must learn to keep these records in a special place.

This is another sort of graduation. I'm sorry to say you won't outgrow the need to keep records, or to pay income taxes. But, I can guarantee that *you will be paid* for your efforts – in the form of tax savings!

Congratulations!

And - - - good luck in your career!

## Tax Facts – How Much We Really Pay

Think you pay too much tax? Of course you do! We all do! You might be surprised at some of the facts released by IRS. They're based on the history of tax returns through year 2011.

When looking at tax return data we need to add a "grain of salt". There are over 310 million people in the USA, but we file just over 140 million tax returns. Often a family files a single return. Many elderly folks and minor children don't need to file at all. Some file, but have enough deductions to eliminate tax. Also, we must remember there are returns showing *negative* income, due to business losses.

**Tax Rates.** For a few years the highest tax rate has been 35%. In 2013 it will be 39.6%. Steep? In 2000 it was also 39.6%. Back in 1980 it was 70%, and in 1960 it was a whopping 91%!

**Tax Revenues.** Form 1040 is the largest revenue generator on the planet. In 2011 personal income taxes generated just over 1.1 *trillion* dollars! This represented 47.3% of all Federal revenue. Payroll taxes gave 35.5%. Corporate income taxes generated only 7.8% of Federal revenue. Excise tax, estate tax, and other taxes generated the missing 9.4%

**Who Pays How Much?** If we could stack the 142 million tax returns from 2011 in order of their gross income, highest at the top, we'd see:

Top 1% show incomes of over \$343,927, and pay 36.7% of all tax.

Top 5% – incomes over \$154,543, paying 58.7% of all income tax.

Top 10% – incomes over \$112,124, paying 70.5% of all income tax.

Top 50% – incomes over \$32,396, with 97.75% of all income tax paid.

The lower 50% *collect* more than they *pay*, because of the earned income credit, but this credit comes from Social Security taxes, not income tax!

**Surprised?** Many couples with income just over \$100,000 probably consider themselves to be "middle income". IRS would definitely call them "wealthy" and place most of them in the top 10% of all incomes.

**Mixed Bag Of Facts.** Here are some of the curious facts compiled by studying all those tax returns:

- Top Tax Rate: Only 0.7% of all filers in 2009 faced the highest 35% tax rate.
- No Tax Liability. In 2011, 46.7% of all returns showed no bottom-line tax liability.
- Payroll tax vs. income tax. For 2011, 62.3% of all filers paid more in total payroll taxes than in actual income tax.

## Tips For You

### Owe IRS? Some Suggestions.

When you owe IRS, they ask you to pay immediately or set up a payment plan. Watch out! The fee to set up a plan is as high as \$105! If you can pay off your balance in three months or less, send what you can now, wait for the next bill, send more, then pay the balance with the third billing. Save the \$105.

If you will need more time, ask for a payment plan. If payments are debited directly from an account, the cost to set up the plan drops to \$52. Low income folks pay only \$43.

IRS charges interest, plus a "late payment" penalty on all balances. Interest changes every quarter. It's currently 3%. The penalty for paying late adds 6%, but is cut in half for payment plans.

**Over 70½? Required Pension Distributions.** At age 70½ folks must take annual distributions from IRA and retirement funds. If you are 70½ or older by year-end, you are affected. The plan custodian likely already sent you a letter informing you of the minimum amount.

You can calculate for yourself. You need two numbers: (1) your account balance on Dec. 31, 2012, and (2) a divisor taken from a life expectancy table. The table is at [www.irs.gov](http://www.irs.gov). Search "required minimum distribution". Using your age on Dec. 31, 2012 you get a

divisor. Divide the account balance by this number – you now have the minimum amount to take.

How to take the money? Your choice. All at once. Now or later. Monthly amount. As long as you take the minimum or more by end of year, all is well.

**Withholding.** Your custodian will offer choices here. I can help you decide an amount likely to keep your tax bill under control.

### Tax-Free Vacation Money.

Summer vacation coming? IRS lets you rent your home for up to 14 days while away. 14 days or less, and you can pocket the money – no taxes. Local papers and on-line services have listings for such rentals. You can pay for a good bit of your own vacation. And – it's legal!

### Over 70½ – IRA To Charity.

2013 is the last year of a tax break for older folks who give to charity. Have your IRA *custodian* send a contribution *directly* to the charity from your IRA. You only pay tax on any *additional* distribution you take. You don't even need to itemize your deductions – the amount sent to the charity is not treated as income. You might have a "double win" here – the reduction in your income may cause less of your social security income to be taxable. Neat.

**Tax Freedom Day** is the day each year when Americans have earned enough money to pay a full year's worth of federal, state, and local

taxes. Total federal taxes last year were \$2.76 trillion, and state & local taxes added \$1.47 trillion. That's 29.4% of the nation's income. The year of 2013 was 29.4% complete on April 18. Thus, April 18 was "Tax Freedom Day".

This is five days later than in 2012. Why? The "fiscal cliff" bill raised several taxes, so we need more time to pay our bills. If we add in federal borrowing (our federal budget deficit) we'd all need to fork over all earnings through May 9 to settle the nations' real tax bills!

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*When there is an income tax, the just man will pay more and the unjust less on the same amount of income.*

Plato

## Your Tax Calendar

June 17	2 <sup>nd</sup> quarter estimated tax payments due
July 31	2 <sup>nd</sup> quarter payroll returns due (Aug. 10 if all deposits were paid). Forms 5500 due for pension or Keogh plans.
Sept. 16	3 <sup>rd</sup> quarter estimated tax payments due
Oct. 15	Extended 2012 returns are late after today.
Today	Be sure to call if you have large changes to income or deductions!